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DEPARTMENT FOR EEB/DAS NELSON, EEB/OMA FOR SAKAUE AND WHITTINGTON, EAP, EAP/ANP AND EAP/EP TREASURY FOR IMB/BILL MURDEN, WILBUR MONROE AND CAROL CARNES NSC FOR BROWN AND LOI

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TAGS: ECON EFIN AS

SUBJECT: G-20 SUMMIT: BACKGROUND ON AUSTRALIA

REF: A. SECSTATE 114420
 IB. CANBERRA 1097 (LATEST AUSTRALIAN THINKING ON G-20 SUMMIT)
 IC. CANBERRA 1096 (PRELIMINARY AUSTRALIAN THINKING ON G-20 SUMMIT)
 ID. CANBERRA 1061 (AUSTRALIA WANTS SEAT AT GFC SUMMIT)
 IE. CANBERRA 1078 (FALL OF THE AUSSIE DOLLAR)
 IF. CANBERRA 1076 (GOVERNMENT FINALIZES DEPOSIT GUARANTEE - FOR NOW)
 IG. CANBERRA 1072 (GOVERNMENT STRUGGLING WITH DEPOSIT GUARANTEE)
 IH. CANBERRA 1043 (AUSTRALIA EXPECTS SLOWER GROWTH)
 II. CANBERRA 1036 (AUSTRALIAN ECONOMIC STIMULUS PACKAGE)
 IJ. MELBOURNE 121 (FORMER TREASURER COSTELLO ON RUDD'S RESCUE PLAN)
 IK. MELBOURNE 123 (MELBOURNE BUSINESSES SEE TOUGH TIMES AHEAD)
 IL. SYDNEY 196 (ECONOMY HOLDING UP AMID GLOBAL FINANCIAL TURMOIL)
 IM. MELBOURNE 114 (VICTORIANS LOSING CONFIDENCE IN U.S. AND GLOBAL ECONOMIES)
 IN. CANBERRA 959 (AUSTRALIA RIDING OUT FINANCIAL TURMOIL -- SO FAR)
 IO. CANBERRA 1010 (CENTRAL BANK SLASHES INTEREST RATES)
 IP. CANBERRA 1020 (TOUGH WEEK FOR THE AUSTRALIAN ECONOMY)
 IQ. CANBERRA 971 (AUSTRALIA'S MOVES ON SHORT SELLS)

Classified By: Economic Counselor Edgard Kagan. Reasons 1.4 (b/d).

11. (SBU) The following is keyed to State 114420.

AUSTRALIAN G-20 SUMMIT KEY OBJECTIVES AND PRIORITIES

12. (C/NF) Australia has three key objectives:

-- To ensure that any reforms to global financial mechanisms do not threaten the effective functioning of financial markets and global capital flows.

-- To have a seat at the table and to support a larger role for the G-20, an organization which Australia sees itself as having helped nurture.

-- To Score domestic political points by showing PM Kevin Rudd playing a major role in helping address the global

financial crisis.

Australia is a capital-intensive economy that has depended on high levels of foreign investment for over 150 years.

Australia has a current account deficit of about 6.2% of GDP.

Following 25 years of reforms, including significant lowering of tariffs and sectoral assistance, Australia is more integrated into the global economy than ever before, which has helped deliver 17 consecutive years of growth. The fall in commodity prices, combined with the credit crunch, financial market turmoil and efforts at the beginning of 2008 to tame rising inflation means the Australian economy will slow sharply and perhaps fall into recession. PM Rudd is eager to reassure the public of his concern and policy efforts by appearing to play a major role.

Public Comments

¶3. (SBU) Prime Minister Rudd stated October 28 that the coming G20 Summit will be an important opportunity for the major players to coordinate responses to the global financial crisis and the economic impact. He stated that G-20 nations must agree on clear, strong, action, including: a framework for the international community to work together to better manage the current financial crisis; common solutions that manage the current financial crisis; common solutions that will serve to mitigate the risks of similar crises re-emerging in the future; and coordinated action to support the global economy to deal with the emerging reality of a likely global recession.

Link at:

http://www.pm.gov.au/media/Speech/2008/speech_0571.cfm

Australia's Official Goals

¶4. (SBU) On 25 September, Prime Minister Rudd made a specific set of proposals about reforming global financial architecture in his address to the United Nations.

Link at:

http://www.pm.gov.au/media/Speech/2008/speech_0502.cfm

The proposal has five key points:

-- That systemically important financial institutions should be licensed to operate in major economies only under the condition that they make full disclosure and analysis of balance sheet and off balance sheet exposures.

-- To ensure that banks and other financial institutions use predictable rules to build up capital as a buffer for the bad times. Supervisory frameworks need to be counter-cyclical not pro-cyclical. The Basel rules need to be changed to deal with this;

-- Financial institutions need to have clear internal incentives to promote financial stability. Regulators should set high capital requirements for financial firms that have executive remuneration packages that reward short term returns or excessive risk taking. Again, the Basel rules need to be changed to deal with this.

-- Supervisory systems must be compatible with financial stability. We need to make sure accounting rules used to evaluate risk take a more medium term perspective. Again the Basel rules need to be changed to address this.

-- The IMF must be given a strengthened mandate for prudential analysis. IMF and the Financial Stability Forum (FSF), in which Australia is an active member, should provide early warning of vulnerabilities and provide advice and remedial policies. These prudential reports by the IMF should form the basis of active engagement with the G20 to shape understanding and action on global risk and system stability.

Link at:

http://www.pm.gov.au/media/Speech/2008/speech_0560.cfm

Key Concerns

¶5. (SBU) The Australian government has emphasized the financial strength of the domestic banking system and the AA ranking of all four major banks, which are ranked in the top

12 in the world. It has guaranteed bank deposits and international borrowing in order to match similar policy initiatives in other countries) so as to maintain the international competitiveness of these banks. The bank guarantee has led to a partial freeze on withdrawals by some non-bank financial institutions, a situation the government is seeking to overcome) possibly by extending the guarantee to financial institutions which increase their level of financial supervision by government authorities such as the Australian Prudential Regulatory Authority (APRA). This issue is still being considered. No Australian financial institutions have failed or have serious liquidity problems.

Impact on Financial Sector

16. (SBU) The impact on Australia's financial sector has been muted in comparison to many other countries. No Australian banks have failed and the Government has not been forced to inject capital into banks. Australia's banking market is Qinject capital into banks. Australia's banking market is dominated by four major banks, which control approximately 80% between them. These four banks are all well-capitalized and continue to report strong profits despite increasing reserves for possible losses. They are also all among the world's 12 remaining AAA-rated banks. However, all four banks depend on overseas borrowing and are having to pay higher funding costs, which they are passing on to their customers. Credit growth has dropped sharply, along with business and consumer confidence. The Australian stock market has fallen sharply, as has the Australian dollar. A number of highly-leveraged firms are facing severe problems. A number of investment funds have frozen withdrawals.

Australia's Steps to Address the Financial Crisis

17. (SBU) The Australian Government has moved aggressively

-- Budget Surplus: On 26 September 2008, Treasurer Wayne Swan announced a government surplus of A\$19.7 billion (1.7 per cent of GDP, equal to USD 13.4 billion) for 2007-08. The surplus was A\$2.9 billion (0.2 per cent of GDP) higher than expected at the time of the 2008-09 Budget, as a result of lower than anticipated spending of A\$3.2 billion, and lower cash receipts of A\$0.4 billion.

-- Support for Mortgage-backed Securities: On 26 September 2008, Treasurer Swan directed the Australian Office of Financial Management (AOFM) to invest in Australian residential mortgage-backed securities (RMBS) as part of the Government's commitment to strong and effective competition in Australia's mortgage market.

-- Bank Deposit Guarantee: On 12 October 2008, the Rudd Government announced it will guarantee deposits in Australian owned banks, locally incorporated subsidiaries of foreign banks, credit unions and building societies for a period of three years. The Government also announced a guarantee on wholesale debt securities issued by these same institutions, on application, and for a fee. On 24 October 2008, Treasurer Swan announced a threshold of A\$1 million for the bank deposit guarantee would be implemented, over which a fee will be charged to receive the benefits of the deposit guarantee. The fee will apply from 28 November 2008. Up until that date all deposits and wholesale funding eligible for the guarantee arrangements will be guaranteed without charge. After that date, deposits over A\$1 million and wholesale funding will only be guaranteed if the relevant fee is paid.

-- Stimulus Package: On 14 October, the Rudd government announced a A\$10.4 billion stimulus package to maintain growth in the Australian economy. This included A\$3.9 billion to provide immediate financial support to help around two million Australian families; A\$5 billion for additional assistance to pensioners and A\$1.5 billion for first home buyer grants.

-- Small Business Package: On 24 October 2008, Prime Minister Rudd announced a package for small business owners to cope with the global liquidity crisis. This included a guarantee of on-time payment for new small businesses contracts with Commonwealth Government Departments and payment of tax by installments for businesses experiencing difficulty.

-- Extra Funding for Regulators: On 28 October, Prime Minister Rudd announced the Rudd Government announced additional funding for APRA, the Australian Securities and Investments Commission (ASIC) and the Treasury. This is to ensure that regulators continue to have the resources they need to maintain the strength of Australia's financial system during the global financial crisis.

Current Economic Situation

¶8. (SBU) Australia's economy was already slowing in the first half of 2008 as the Reserve Bank of Australia (RBA) tried to bring rising inflation under control. This significantly reduced consumer and business confidence going into September. The RBA was worried that the significant increase in Australia's terms of trade (expected to be 16-20% for 2008) would fuel inflation. Experts are now divided about the extent of the slowdown in Australia. On 30 October 2008, the Deputy Governor of the Reserve Bank emphasized that no one knows the exact impact of the financial crisis on Australian growth for coming quarters. Other contacts predict a mild recession, with close to zero growth in the fourth quarter of 2008 and contraction in the first and possibly second quarters of 2009. The key variable will be the extent of the slowdown in Asia, as Australian contacts believe that this will play a role. Inflation recently increased to 5% on an annual basis, but the Reserve Bank expects this to moderate downwards over time. The impact of the crisis on Australia's current account is also unclear but falling commodity prices must have an adverse impact as 60-65% of exports are commodities. However, major commodities such as coal and iron ore recently recorded record contract prices and these are locked in until April 2009. The Australian dollar recently fell nearly 40% from U.S. 98 cents to U.S. 60 cents but has recovered a little to reach around U.S. 68 cents October 30. This depreciation will offset commodity price falls and also make other export sectors more competitive. The budget deficit position has been affected by the decision on 14 October to implement a A\$10.4 billion budget stimulus package. The projected surplus for 2008-09 of around A\$22 billion will be further eroded by declining tax revenues due to the resource sector slowdown and the overall slower rate of economic growth. The likely impact of these factors on the budget deficit is still unclear. There will be a Mid-Year Economic Statement next month.

Mission Point of Contact

¶9. (SBU) Primary Point of Contact on G-20 Summit issues is Economic Counselor Edgard Kagan (Office: 61-2-6214-5759; Home: 61-2-6161-3668; Cell: 61-4-0936-0889; email: kaganed@state.gov; class email: kaganed@state.gov.sgov).

Mission Australia Reporting

¶10. (SBU) Refs B and C reported evolving Australian thinking on the Summit. Ref D reported on Australia's efforts to secure an invitation to the Summit. Ref E looked at the Australian dollar's rapid depreciation. Refs F and G addressed issues surrounding the Australian Government's guarantee of bank deposits. Ref H reported on the perspectives of Australia's Treasury Secretary. Ref I reported on the Government's stimulus package and Ref J reported on former Treasurer Peter Costello's views on the stimulus package. Ref K-M reported on views from business and government contacts in Melbourne and Sydney. Ref N reported on the initial perspectives of senior government and

Reserve Bank contacts as the crisis unfolded. Refs O-Q reported on developments as they occurred.

McCallum